No. 12954

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

TITLE AND TRUST COMPANY, A CORPORATION, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 27-41) are reported at 15 T. C. 510.

JURISDICTION

This petition for review (R. 43-49) involves a proceeding with respect to a deficiency in excess profits tax determined by the Commissioner (R. 11-14) against Title and Trust Company, a corporation (hereinafter referred to as "the taxpayer"), for the year 1945 in the amount of $36,377.35. The taxpayer is an Oregon corporation, and has its office and principal place of business in Portland, Oregon. (R. 18, 19, 28-29.) The

taxpayer filed its income and excess profits tax returns for the calendar year 1945 with the Collector of Internal Revenue for the District of Oregon. (R. 19, 29.) By letter dated November 2, 1948 (R. 11-14), the Commissioner of Internal Revenue notified the taxpayer that the determination of its excess profits tax liability for the year 1945 disclosed a deficiency in the amount above stated. Within ninety days thereafter, namely, on January 19, 1949 (R. 3), the taxpayer filed with the Tax Court a petition (R. 5-14) for a redetermination of the deficiency determined by the Commissioner as above stated, pursuant to Section 272 of the Internal Revenue Code. On December 13, 1950, the Tax Court entered its decision (R. 42), finding an overpayment in excess profits tax for the year 1945 in the amount of $3,713.29. Less than three months thereafter, namely, on February 28, 1951 (R. 4, 49), the Commissioner filed his petition (R. 43-49) for a review by this Court of the decision of the Tax Court, pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court erred in allowing the taxpayer, a title insurance company, an exclusion from or reduction of its gross underwriting income for the taxable year 1945 under Section 204 (b) (5) of the Internal Revenue Code in the amount of $46,889.63 (or any part thereof), representing 3 per cent of the total premiums received by the taxpayer on title insurance contracts written by it during the four calendar years 1942 to 1945, inclusive.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations involved are set forth in the Appendix, *infra.*

STATEMENT

The facts in this case, which were stipulated (R. 18-27),[1] were recited by the Tax Court, in somewhat summarized fashion, in its separately stated "Findings of Fact" as follows (R. 28-35):

The taxpayer is a corporation legally qualified by the State of Oregon to carry on the business of insuring titles to real estate, and has its principal place of business in Portland, Oregon. During the taxable year 1945, over 75 per cent of its gross income was derived from its title insurance business in connection with which it issued exclusively perpetual title insurance policies. (R. 28-29.)

The taxpayer files its returns and keeps its books on the accrual basis. Its income and excess profits tax returns for the calendar year 1945 were filed with the Collector of Internal Revenue for the District of Oregon. The Commissioner mailed the deficiency notice involved in this proceeding to the taxpayer on November 2, 1948. (R. 29.)

On December 26, 1945, the taxpayer received from the Insurance Commissioner of the State of Oregon the following directive (R. 29-32):

> Pursuant to Section 101-136, O.C.L.A., an examination of your Company was made as of September 30, 1945, by a duly authorized examiner of this Department. Enclosed herewith is a copy of the examination report.
>
> On page 23 of said report attention is called to the advisability of making adequate reserve provision for unearned premiums. Study has been

[1] In addition to the stipulation of facts, there were adduced in evidence at the hearing before the Tax Court (R. 17) the taxpayer's income and declared value excess profits, and excess profits tax returns for the year 1945, as respondent's Exhibit A. That exhibit was omitted from the printed record before the Court, since it was not deemed material to the consideration of this review.

given by the Department towards the formulation of a reasonable, adequate, and sound rule for the determination of such a reserve. Consideration was given to the trend of your experience, premium volume, and size and types of risks underwritten. In order to make broader comparison with the requirements and procedures followed in other states as regards such reserves, the statutes of the various states were analyzed. As a consequence, in accordance with the provisions of Section 101-137, O.C. L.A., the following rule has been promulgated as applicable to your company.

1. The Title and Trust Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:

(a) As at December 31, 1945, or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and

(b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;

(c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purposes.

2. As at December 31, 1945, the Title and Trust Company may charge against and reduce thereby the "Title Loss Reserve" carried in the amount of $50,000.00 the total of losses paid during the four calendar years 1942, 1943, 1944, and 1945 on account of title policies issued; and monthly thereafter all such losses paid during the preceding calendar month may be similarly charged against this reserve. Provided, however, that the amount of said reserve shall never be less than an amount at least equal to the aggregate estimated amount due or to become due on account of all unpaid losses and claims upon title insurance policies of which the company has received notice nor less than the aggregate of title losses incurred during the preceding 36 months. After the expiration of 180 months from January 1, 1942, the balance in this reserve account, in excess of the aforementioned estimated amounts for claims due or accrued or 36 months aggregate losses, may be released and be available for any corporate use or purpose.

3. Commencing January 1, 1946, the Title and Trust Company shall not issue a policy of title insurance for a single transaction, the face amount of which shall exceed an amount which is five times the capital and surplus of your Company; but nothing herein shall prevent the Title and Trust Company from assuming the risk on a single policy jointly with another title insurance company or companies in excess of five times the Title and Trust Company's capital and surplus, provided that the total amount of such insurance shall not exceed five times the total combined capital and surplus of all such companies liable under such insurance; and provided that each such company shall not assume more than its proportionate share of the total amount at risk in accordance with the above-defined maximum retention limit.

If at any date subsequent hereto, upon review or examination as provided in the Oregon Insurance Laws, it is determined that the reserves and procedures established by the rules as promulgated

above are inadequate for the safety and welfare of the policyholders and not in the best interests of the company operations, said rules will be modified as necessary; furthermore, should any statute hereafter be adopted by the State of Oregon bearing on this subject, then any sections of these rules inconsistent or in conflict with said statute or statutes shall be automatically voided.

In compliance with the above directive, the taxpayer set up on its books on December 31, 1945, an account captioned "Unearned Premiums" with a credit to that account in the amount of $46,889.63 and a corresponding debit to "Undivided Profits." (R. 32.) The figure of $46,889.63 was determined in accordance with the above directive of the Insurance Commissioner as follows (R. 33):

1942 Premium	$238,305.09	3%	$ 7,149.15
1943 Premium	$330,204.13	3%	9,906.12
1944 Premium	$433,552.98	3%	13,006.59
1945 Premium	$560,926.28	3%	16,827.77
Total			$46,889.63

The losses paid by the taxpayer during each of the calendar years 1942, 1943, 1944 and 1945 on account of title insurance policies previously issued by it were charged on its books in each of the above years to the "Undivided Profits" account and were claimed as deductions on its income tax returns for those years in the following amounts (R. 33):

Year	Amount
1942	$2,157.52
1943	1,126.97
1944	2,267.77
1945	7,394.39

Other than as indicated by the losses paid by the taxpayer in the above years, there were no estimated un-

paid losses or claims upon title insurance policies of which the taxpayer had notice during those years. (R. 33.)

Among the items of liabilities shown on the taxpayer's balance sheets as at the beginning and close of the calendar year ended December 31, 1945, were the following (R. 33):

	Beginning	Close
Reserve for Title Insurance Losses	$50,000.00	$50,000.00
Reserve for Unearned Premiums		46,889.63

The above-described "Reserve for Title Insurance Losses" balance sheet item was carried on the taxpayer's books in an account captioned "Reserve for Contingencies" and represented a surplus reserve, no part of which has been claimed as a deduction on any income tax return filed by the taxpayer. This "Reserve for Contingencies" account was set up on the taxpayer's books on July 26, 1934, by a credit to that account in the amount of $500 with continuing monthly credits of like amounts until December, 1935, and thereafter like monthly credits of $1,000 until May 31, 1939, when the credit balance of the account equalled $50,000. In each instance the corresponding debit entry was to "Contingent Losses," the annually accumulated debit balances of this account being charged to "Surplus." (R. 33-34.)

Of the securities owned by the taxpayer and listed among the assets shown on its balance sheet as at December 31, 1945, securities of a value of $100,000 were, on that date, on deposit with the Treasurer of the State of Oregon as a "Guarantee Fund" as required by the insurance laws of the State of Oregon. (R. 34.)

In its income and declared value excess profits tax return for the year 1945, the taxpayer reported a gross

income of $601,664.97, consisting of the following items (R. 34):

Title Insurance premiums (home and branch offices)	$560,926.28	
Less: "Unearned Premiums"	46,889.63	$514,036.65
Abstract premiums (home and branch offices)		26,426.70
Commissions (trust, escrow and general)		29,991.76
Interest		13,132.36
Rents		17,312.50
Dividends		765.00
Total gross income reported		$601,664.97

This amount, as offset by items of $375 and $9,523.16, representing non-taxable interest and net long-term capital gain, respectively, neither of which items is here in controversy, resulted in net income of $203,935.77 reported in the taxpayer's return. In the determination of the deficiency, the Commissioner disallowed as an exclusion or deduction from the taxpayer's gross income the amount of $46,889.63 reported on the return as "Unearned Premiums" with the following explanation (R. 35):

> In a schedule attached to your income and declared value excess profits tax return for the year 1945 you reported title insurance premiums in the total amount of $560,926.28. You reported that $46,889.63 of such total premiums constituted "unearned premiums" and credited that sum to a "reserve for unearned premiums." The sum of $46,889.63 was not included in the net income reported.
>
> The Bureau holds that title insurance premiums received in the total amount of $560,926.28 during

> the year 1945 were earned in that year. Net income reported has, therefore, been increased by the sum of $46,889.63.

The Tax Court held (R. 35-41) that the Commissioner had erred in his determination that the taxpayer could not exclude from its 1945 gross income the $46,889.63 in question as "Unearned Premiums," and accordingly entered its decision finding an overpayment in excess profits tax for 1945 in the amount of $3,713.29 (R. 42). The present review followed.

STATEMENT OF POINTS TO BE URGED

The points urged and relied upon by the Commissioner on the present review were originally stated at length by him in his petition for review (R. 46-49), and were later restated by him in this Court (R. 56) in a composite or summarized fashion substantially as follows:

The Tax Court erred in allowing the taxpayer a deduction from or reduction of its gross income for the taxable year 1945 in the amount of $46,889.63, or any part thereof, on account of so-called "unearned premiums" for the years 1942 to 1945, inclusive, and as a result thereof in expunging the deficiency determined by the Commissioner against the taxpayer for the year 1945 in the amount of $36,377.35.

SUMMARY OF ARGUMENT

This review involves a question substantially identical to that presented in *United States* v. *Pacific Abstract Title Co.,* now pending before this Court as Cause No. 12,894. For the reasons pointed out in our brief in the *Pacific Abstract* case, and the additional comments made hereinafter, it is submitted that the holding of the Tax Court in this case is erroneous and should be reversed.

ARGUMENT

The Taxpayer Was Not Entitled to a Deduction under Section 204 (b) (5) of the Internal Revenue Code for the Reserve Required to Be Maintained by the Directive of the Insurance Commissioner of Oregon Purportedly as a Reserve for "Unearned Premiums"

With certain minor differences in factual details, which will be hereinafter referred to, this case is identical to the case of *United States* v. *Pacific Abstract Title Co.,* Cause No. 12,894, before this Court on appeal from the United States District Court for the District of Oregon. Therefore, in order to avoid burdening this Court with unnecessary repetition, we adopt in this case and incorporate herein by reference the argument advanced in the brief heretofore filed in this Court in the *Pacific Abstract Title Co.* case on behalf of the appellant, the United States, and respectfully request that it be considered in this case.

In our brief before this Court in the *Pacific Abstract* case, in support of our position that the taxpayer there was not entitled to the deduction of the reserve in question, as a purported reserve for "unearned premiums," in the determination of taxable income, we advanced the following contentions, briefly stated: (1) Because of the inherent nature of title insurance, premiums are fully earned when the policies are written and no portion thereof may be treated as "unearned premiums" and as such be excluded or deducted from gross income for tax purposes; (2) the Insurance Commissioner of the State of Oregon exceeded his authority when he purported by his directive to convert (retroactively) any portion of the premiums previously fully earned by the taxpayer into "unearned premiums"; (3) even if the reserve which the Insurance Commissioner required the taxpayer to establish purportedly as an "unearned premium" reserve might possibly be viewed as a valid

reserve of another character under the Oregon statute, it would still not be deductible for tax purposes, because insurance companies of the class taxable under Section 204 of the Internal Revenue Code (Appendix, *infra*) are not entitled to the deduction of any reserves in the computation of taxable income; and, finally, and in the alternative, (4) even if it were held that the Insurance Commissioner could convert some part of title insurance premiums into "unearned premiums, his action could not be given effect *retroactively*" for tax purposes, so as to convert retroactively a portion of the premiums previously written and fully earned by the taxpayer into "unearned premiums." We adopt those contentions in this case, and upon the basis thereof respectfully submit that the decision of the Tax Court in this case, allowing this taxpayer to deduct the disputed reserve as a purported reserve for "unearned premiums," should be reversed.

The factual differences between this case and the *Pacific Abstract* case, though in minor detail, all—with one exception, which, as hereinafter brought out, relates only to the alternative contention (stated under "(4)" in the preceding paragraph) against retroactive application of the directive—serve to demonstrate even more effectively the correctness of the Government's position that the disputed reserve involved in the two cases is not deductible in the determination of taxable income.

The first factual difference to which we may call attention is the fact that the taxpayer in this case had, before the taxable year here involved (1945), voluntarily set up and accumulated a reserve in the amount of $50,000 described as a "Reserve for Title Insurance Losses," by periodic credits to an account on its books captioned "Reserve for Contingencies" between

July 26, 1934, and May 31, 1939.[2] (R. 24-25, 33-34.) The amounts credited to that reserve by the taxpayer had been charged to "Surplus," and no part thereof had ever been claimed as a deduction for tax purposes by the taxpayer. (R. 25, 34.) By the same directive which required the establishment of the purported "unearned premium" reserve in question, the Insurance Commissioner authorized the taxpayer in this case to take out of and reduce this $50,000 "Title Loss Reserve," as of December 31, 1945, by the total of losses paid on account of title policies during the four years 1942 to 1945, inclusive, and thereafter to charge against that reserve each month all losses paid during the preceding month. (R. 21.) The authorized taking down or reduction of that loss reserve was limited by a proviso to the effect that the amount in the reserve should never be less than an amount equal to the aggregate estimated amount of all unpaid losses and claims of which the taxpayer has received notice, nor less than the aggregate of title losses incurred during the preceding 36 months. (R. 21.) The directive further provided that after the expiration of 180 months from January 1, 1942,[3] the balance remaining in this loss reserve in excess of the above-mentioned alternative minimums would be released and be available for any corporate use or purpose. (R. 21.)

This authorized release of the previously established voluntary loss reserve serves to demonstrate more convincingly than ever, we believe, that the purported "unearned premium" reserve was in reality a reserve against contingent losses which might arise in the

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[2] No reserve of this character had been previously set up by the taxpayer in the *Pacific Abstract* case, at least insofar as disclosed by the record in that case.

[3] Similarly, at the same time, 180 months after January 1, 1942, the purported "unearned premium" reserve was to begin to be released. (R. 21.)

future—i.e., losses then unknown, of which the taxpayer as yet had received no notice, but which were expected to arise in the future. In net result, what the Insurance Commissioner of Oregon required the taxpayer to do by the directive in question was to maintain (1) a reserve to cover the estimated amount of *known* losses unpaid and outstanding (which he required be maintained as a minimum in the previously established loss reserve above mentioned) and (2) a reserve to cover *unknown* or contingent losses expected to arise in the future (which he required be set up as a purported "unearned premium" reserve).[4]

It is, of course, a well settled general principle of tax law that reserves set up for future or contingent losses cannot be deducted for tax purposes. See *Lucas* v. *American Code Co.,* 280 U.S. 445; *Brown* v. *Helvering,* 291 U.S. 193; *Security Mills Co.* v. *Commissioner,* 321 U.S. 281; *Spencer, White & Prentis* v. *Commissioner,* 144 F. 2d 45 (C.A. 2d), certiorari denied, 323 U.S. 780; *Capital Warehouse Co.* v. *Commissioner,* 171 F. 2d 395 (C.A. 8th). As brought out in our *Pacific Abstract* brief in this Court (pp. 26-28), insurance companies other than life or mutual, taxable under Section 204 of the Code, are not entitled to the deduction of any reserves in the computation of taxable income. And, we may add, the mere fact that a reserve is required by state law is not of itself sufficient to entitle a taxpayer to a deduction therefor. See *American Title Co.* v. *Commissioner,* 29 B.T.A. 479, 482, affirmed, 76 F. 2d 332, 333 (C.A. 3d), and *Pacific*

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[4] The same is the net result, in effect, of the directive issued to the taxpayer in the *Pacific Abstract* case, which directive required that taxpayer to set up and maintain thereafter a "Title Loss Reserve" at least equal to the aggregate estimated amount of *known* losses unpaid, but not less than the aggregate of title losses incurred during the preceding 36 months. (*Pacific Abstract,* R. 39.)

Employers Insurance Co. v. *Commissioner,* 33 B.T.A. 501, 503, affirmed, 89 F. 2d 186 (C.A. 9th).[5]

Another difference between the instant case and the *Pacific Abstract* case is that the record in this case shows affirmatively that this taxpayer took deductions on its income tax returns for the amount of the losses paid on account of title policies during the taxable year 1945, as well as during the years 1942, 1943 and 1944. (R. 24, 33.) Since a deduction has already been taken for losses paid, to allow the taxpayer to also deduct this purported "unearned premium" reserve, which is really a reserve for contingent losses, would be to allow a double deduction, which would be contrary to settled principles of income tax law.

Another difference between the two cases is that the record in the instant case shows that the amount of the disputed reserve purportedly for "unearned premiums" has actually been charged by the taxpayer on its books against its "Undivided Profits" account.[6] (R. 23.) In our view that is the correct treatment of the reserve: As pointed out in our *Pacific Abstract* brief (p. 31), the amount of this purported "unearned premium" reserve should be established out of the earned surplus of the company. It is unquestionable that it is not a proper charge against the 1945 income of the taxpayer and should not be allowed as a deduction for tax purposes from the taxpayer's 1945 income.

The last difference between the instant case and the *Pacific Abstract* case is that the directive of the In-

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[5] This Court recently adhered to its *Pacific Employers* decision in *Pacific Ins. Co.* v. *United States,* 188 F. 2d 571, now pending before the Supreme Court on a petition for certiorari (No. 77, October Term, 1951), in response to which the Government has filed a memorandum not opposing the granting of the writ.

[6] It may be pointed out that in this respect the Tax Court was in error when it stated, in the course of its opinion in the instant case, that the amount of the reserve "was taken from 1945 income." (R. 40.)

surance Commissioner, requiring the establishment of the purported "unearned premium" reserve, was issued and delivered to this taxpayer on December 26, 1945.[7] (R. 19, 29.) This is the one factual difference between the two cases which relates only, as we have indicated, to the alternative contention against the retroactive application of the directive, to which we have referred as the fourth contention advanced in our *Pacific Abstract* brief. Because the directive to the taxpayer in this case was issued on December 26, 1945, our alternative argument against retroactive application in this case is slightly modified. In this case our alternative position is that, even if it were held that the Insurance Commissioner could convert some part of title premiums into "unearned premiums," his action could not be given effect retroactively for tax purposes with respect to premiums written and fully earned by this taxpayer before the date of the directive, December 26, 1945. In other words, the directive, if valid, could be effective to convert into "unearned premiums" three per cent of the premiums written after the directive was issued on December 26, 1945, and up to the end of the taxable year, December 31, 1945. Therefore, if the directive were valid, the most that the taxpayer would have been entitled to exclude from gross income would have been three per cent of the premiums written between December 26 and December 31, 1945. Since the taxpayer has failed to establish the amount of the premiums written between December 26 and December 31, 1945, however, it would not in any event be entitled to any deduction or exclusion from gross income on account thereof because of its failure of proof in that respect.

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[7] The directive to the taxpayer in the *Pacific Abstract* case was issued on January 12, 1946. (*Pacific Abstract,* R. 26, 37.)

CONCLUSION

It is submitted that the decision of the Tax Court in this case is erroneous and should be reversed, and that the determination of the Commissioner of Internal Revenue should be reinstated.

Respectfully submitted,

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September, 1951.

APPENDIX

Internal Revenue Code:

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(a) [As amended by Section 164(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and by Section 135(a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Imposition of Tax.*—

(1) *In General.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income and upon the corporation surtax net income of every insurance company (other than a life or mutual insurance company) and every mutual marine insurance company and every mutual fire insurance company exclusively issuing either perpetual policies, or policies for which the sole premium charged is a single deposit which (except for such deduction of underwriting costs as may be provided) is refundable upon cancellation or expiration of the policy taxes at the rates specified in section 13 or section 14(b) and in section 15(b).

*   *   *   *   *

(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) [As amended by Section 135(b) of the Revenue Act of 1943, *supra*]. *Gross Income.*—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22; except that in the case of a mutual fire insurance company described in

paragraph (1) of subsection (a) of this section, the amount of single deposit premiums paid to such company shall not be included in gross income;

(2) *Net Income.*—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) *Investment Income.*— * * *

(4) *Underwriting Income.* —"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) [As amended by Section 164(b) of the Revenue Act of 1942, *supra*]. *Premiums Earned.*—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. For the purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 201 (c)(2), pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 201 (b);

(6) *Losses Incurred.*— * * *

(7) *Expenses Incurred.*— * * *

(c) [As amended by Section 226 of the Revenue Act of 1939, c. 247, 53 Stat. 862, Sections 124 and 164 of the Revenue Act of 1942, *supra*, and Section 135 of the Revenue Act of 1943, *supra*]. *Deductions Allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b)(6) of this section;

(5) *Capital losses.*—Capital losses to the extent provided in section 117 plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. * * *

* * * * *

(6) Debts in the nature of agency balances and bills receivable which become worthless within the taxable year;

(7) The amount of interest earned during the taxable year which under section 22 (b)(4) is excluded from gross income;

(8) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (l);

(9) Charitable, and so forth, contributions, as provided in section 23 (q);

(10) Deductions (other than those specified in this subsection) as provided in section 23;

(11) Dividends and similar distributions paid or declared to policyholders in their capacity as such, except in the case of a mutual fire insurance company described in paragraph (1) of subsection (a) of this section. The term "paid or declared" shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company.

* * * * *

(e) *Double Deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

* * * * *

(26 U.S.C. 1946 ed., Sec. 204.)

Treasury Regulations **111**, promulgated under the Internal Revenue Code:

> Sec. 29.204-1 [As amended by T.D. 5369, 1944 Cum. Bull. 333, 334]. *Tax on Insurance Companies Other Than Life or Mutual and Mutual Marine Insurance Companies and Mutual Fire Insurance Companies Issuing Perpetual Policies.*—All insurance companies, other than life or mutual or foreign insurance companies not carrying on an insurance business within the United States, and all mutual marine insurance companies and mutual fire insurance companies exclusively issuing either perpetual policies, or policies for which the sole premium charged is a single deposit which, except for such deduction of underwriting costs as may be provided, is refundable upon cancellation or expiration of the policy, are subject to the tax imposed by section 204. * * * The net income of insurance companies is defined in section 204 and differs from the net income of other corporations. * * * Since section 204 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the returns under section 204 shall be made on the basis of the calendar year and shall be on Form 1120. * * *
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>
> Sec. 29.204-2 [As amended by T.D. 5369, *supra*]. *Gross Income.*—Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from the sale or other disposition of property, and all other items constituting gross income under section 22, except

that in the case of a mutual fire insurance company described in section 29.204-1 the amount of single deposit premiums received, but not assessments, shall be excluded from gross income. * * * The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Code. * * * In computing "premiums earned on insurance contracts during the taxable year" the amount of the unearned premiums shall include (1) life insurance reserves as defined in section 201 (c)(2) and section 29.201-4 pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by section 204 and not qualifying as a life insurance company under section 201 (b), and (2) liability for return premiums under a rate credit or retrospective rating plan based on experience, such as the "War Department Insurance Rating Plan," and which return premiums are therefore not earned premiums. * * *

Sec. 29.204-3 [As amended by T.D. 5369, *supra*]. *Deductions.*—The deductions allowable are specified in section 204 (c) and by reason of the provisions of section 204 (c)(10) include deductions (other than those specified in section 204 (c) as provided in section 23. * * *

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7 Oregon Compiled Laws Annotated (1940):

Sec. 101-105.—*General powers and duties of commissioner.* (1) The insurance commissioner shall have and exercise the power to enforce all the laws of the state relating to insurance, and it shall be his duty to enforce all the provisions of such laws for the public good. He shall issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of

the provisions of this act, but nothing contained in this act shall be construed to prevent any company or persons affected by any order or action of the insurance commissioner from testing the validity of same in any court of competent jurisdiction.

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(3) [Furnishing of form for financial statement.] Every insurance company, doing business in the state, shall file with the commissioner, on or before March 1st of each year, a financial statement for the year ending December 31st immediately preceding on [a] form furnished by the commissioner, which shall conform as nearly as may be to the form of statement from time to time adopted by the national convention of insurance commissioners, and containing such detailed exhibit of the condition and transactions of the company as the commissioner, in such form and otherwise shall reasonably prescribe. Such statement shall be verified by the oaths of the president and secretary of the company, or in their absence by two other principal officers. The statement of a company of a foreign country shall embrace only its condition and transactions in the United States, and shall be verified by the oath of its resident manager or principal representative in the United States. In the discretion of the commissioner, a penalty of ten dollars per day shall attach for delinquency in filing such statement.

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SEC. 101-136. (*Examination into affairs of company or persons in insurance business: Appointment of examiners: Duty to produce books and papers and to facilitate examination: Report of examiners: Hearing: Inspection and publication of report: Expenses of examination.*) The insurance commissioner shall, whenever he deems it advisable in the interest of policyholders or for the public good, examine into the affairs of any insurance company, agency, corpora-

tion, partnership, person or persons engaged in or proposing to engage in the insurance business of this state, and into the affairs of any company organized under any law of this state or having an office or representative in this state, which company is engaged in or is claiming or advertising that it is engaged in organizing or receiving subscriptions for or disposing of stock of, or in any manner aiding or taking part in the formation or business of an insurance company or companies, or which is holding capital stock of one or more insurance companies for the purpose of controlling the management thereof as voting trustee or otherwise. * * * It shall be the duty of the insurance commissioner to examine every domestic insurance company at least once in three years.

Sec. 101-137. *Examination: Reserve: Liability: (Formulating or adopting rules).* In ascertaining the condition of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy, or examiner, he shall allow as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the existing laws of the state or country under which such company is organized and which investment he may approve or reject, but unpaid premiums on policies written within three months shall be admitted as available resources. In ascertaining his liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other

states or approved by the national convention of insurance commissioners.

SEC. 101-138. *Revocation of certificate or license: Court review.* (1) If the commissioner shall find upon examination or other evidence that any insurance company is in an unsound condition, or that it has failed to comply with the law or with the provisions of its charter or articles of incorporation or association, or that its condition is such as to render its proceedings hazardous to the public or to its policy-holders, or that its actual assets exclusive of its capital are less than its liabilities, or if its trustees, directors, officers, or agents refuse to submit to examination or to produce at the office where the same are kept, its books, records, accounts, and papers in its or their possession or control relating to its business or affairs, for examination and inspection of the commissioner, his deputy or examiner, when required, or shall refuse to perform any legal obligation relative to such examination, the commissioner shall revoke or suspend all certificates of authority and licenses granted to such insurance company, its officers or agents, and shall cause notice thereof to be given to such company and to each agent of such company in this state and no new business shall thereafter be done by such company or for such company by its agents, in this state, while such revocation, suspension, or disability continues, nor until its authority to do business is restored by the commissioner.

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